

INTERNAL AUDIT NEWSLETTER

ISSUE #RRCO-IA06

FORENSIC AUDITING: A KEY TO UNCOVERING FINANCIAL FRAUD

Let's take a brief introduction of the topic:

In today's complex business environment, financial transparency and accountability are essential for organizations. Financial fraud and misconduct continue to pose challenges.

This is where forensic auditing comes into play. Forensic auditing is a specialized field that combines accounting expertise with investigative skills to uncover fraud, financial discrepancies, and other forms of financial misconduct.



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LET'S TAKE AN EXAMPLE

Brighton Co. noticed their sales numbers were unusually high, but the profit margins didn't match up. When they investigated, they found some suspicious sale transactions and brought in a forensic auditor.

The auditor discovered that the sales manager had been inflating sales figures and creating fake orders to earn higher commissions. This fraud went unnoticed for a while which later was discovered by the forensic auditor.



“As many as 59% of the Indian organizations surveyed said that they had faced financial or economic frauds in the past 24 months, compared with 41% globally and 52% as per 2022 edition”

-PwC's Global Economic Crime Survey

Complex Financial Transactions

As businesses grow and global operations evolve, the risk of fraud increases. Forensic auditors perform in-depth investigations to detect and expose concealed fraudulent activities.

Protecting Reputation

Fraud incidents can damage a company's reputation and erode stakeholder trust. Forensic auditors help to handle the fraud in such a manner that will save the trust of the business users.

Increased Systemic Weaknesses

All businesses in recent days, are handling a lot of data with the help of various software and modern technology. As these technologies are more prone to unauthorized access and misuse. This leads to malfunction by the user.

Asset Embezzlement

Due to increased size and complexity of asset handling at each organization, the assets which are small in size are more likely to be embezzled by the user of asset and organization might not notice because of large volume of assets.

THE ROLE OF WHISTLEBLOWER POLICIES AND CODE OF CONDUCT IN INITIATING FORENSIC AUDITING

Whistleblower policies and a strong code of conduct are key tools for spotting and addressing financial issues, often triggering forensic auditing investigations. Here's a simpler breakdown:

Encourage Reporting:

They provide a secure channel for employees and stakeholders to report unethical or illegal actions without fear of retaliation.

Whistleblower Policies

Start Investigations :

Whistleblower reports often reveal suspicious activities, leading to forensic auditing inquiries into fraud.

Ensure Compliance :

A whistleblower policy promotes transparency by enabling safe reporting of misconduct, ensuring compliance with legal and ethical standards.

Set Standards :

It defines ethical behaviour, helping prevent misconduct, increase transparency, and ensure accountability in financial practices.

Code of Conduct

Guide Evaluations :

Forensic auditors use it to identify violations of rules that may signal fraudulent activity

Promote Accountability:

It enforces consequences for unethical actions, making forensic auditing essential to investigate breaches and measure their impact.

OTHER TOOLS: ADDRESSING THE MISCONDUCT



Dedicated Email/ Hotline

Confidential channels for reporting fraud or violations.

Independent Employee Survey

Yearly or quarterly surveys on employees' portal for feedbacks

Ethics Committee

Teams to oversee investigations and take action.

Employee Training

Programs to raise awareness about misconduct and reporting.

Risk Advisors

Regular checks and automated tools to detect anomalies

Open-Door Policies

Encourage direct communication with managers or HR

MISCONCEPTIONS ABOUT **FORENSIC AUDIT**



Forensic auditing is only relevant to the finance department

Forensic auditing isn't just for the finance department; it applies to all areas like HR, Payroll, Purchase, and Sales, because fraud can be committed by any person in any department.

Forensic Auditors Are the Same as Traditional Auditors

While both professions deal with financial information, their objectives differ. Traditional auditors assess financial statements for accuracy and compliance, whereas forensic auditors investigate specific suspicious fraud or financial misconduct.

Forensic Auditing Is Only for Large Corporations

Forensic auditing services are valuable to organizations of all sizes. Small and medium-sized enterprises can benefit from forensic auditors to detect and prevent financial discrepancies.

Forensic Auditors Only Focus on Internal Fraud

Forensic auditors investigate both internal and external fraud, including vendor fraud, insurance fraud, and other financial crimes affecting an organization.

Forensic Auditors can get Involved before a Crime Occurs

Forensic auditors are always involved after the fraud has been committed or a complaint of the suspicious fraud is received through whistle blower policy or other tools to investigate the impact of the fraud.

Forensic Audit: **The Right Time to Act !**



Regulatory Compliance and Reporting:

Regulatory bodies may require an organization to disclose fraud and the measures to address it. Forensic audit ensures that the organization complies with such regulations and appropriate reports are filed.

Settling Claims with Insurance:

If fraud has affected the organization and there's insurance coverage, forensic audit is often necessary to establish the full financial impact and document the loss. The audit can provide evidence required for filing claims and determining the appropriate amount of compensation.

Gathering Evidence for Legal Action:

Once fraud is identified, forensic audit provides crucial evidence for legal proceedings, whether the organization intends to pursue civil litigation or report the fraud to law enforcement. The detailed evidence collected in the audit can be used in court as part of the investigation or prosecution.

Uncovering the Methods of Fraud:

Forensic audit digs into how the fraud was carried out. This could involve analyzing fraudulent invoices, falsified financial reports, unauthorized transactions, or other deceptive practices. Understanding how the fraud occurred is essential for legal action or remediation.

Audit Observation

Collusion and Fraud in Procurement Process Leading to Financial Loss

During a forensic auditing investigation of the procurement department, the investigation revealed that large purchase orders were given to a single vendor without proper checks. It was observed that the vendor provided goods at prices significantly higher than the prevailing market rates for similar products.

Further there was a complaint from whistleblower highlighting the situation and on further investigation and physical verification of procured goods it revealed that a procurement officer was working with the vendor and approving fake transactions in return for kickbacks without actually receiving the goods. This fraud highlighted the need for better controls in the procurement process.



Risk Involved

Fraud in the procurement department can cause big financial losses through overpayments, fake contracts, and missing goods. It increases costs and reduces profits, harming the company's financial health.

Recommendation

To address this risk, the company should implement a more rigorous vendor selection and approval process. It should enforce the segregation of duties within the procurement process, ensuring that no single individual is responsible for both selecting vendors and approving transactions.

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